

Points of Basic Policy for Financial Inspections in Program Year 2011

Basic Policy for Financial Inspections The FSA creates and publishes its Basic Policy for Financial Inspections at the start of each program year (from July to June the next year), in order to clarify the basic framework for inspection management and priority examination items, etc.

Main Contents of Basic Policy for Financial Inspections in Program Year 2011

Japan's economy faces risk factors, such as harsh conditions due to impacts of the Great East Japan Earthquake, and recession in overseas economies. Under such circumstances, financial institutions are expected to function as a backup supporter of the real economy and firms. Financial institutions are also expected to lead the economy by acting as a growth industry.

Considering these conditions, the basic objectives of inspections should be to examine whether financial institutions have (1) developed systems to provide an appropriate financial intermediary function, (2) constructed a sufficient financial base to play such a role as well as a robust and comprehensive risk management system.

While enhancing the authorities' seamless on-site and off-site monitoring, inspection priorities will be financial institutions' handling of financial facilitation (e.g. wielding of consulting function, such as when changing loan conditions), business continuity management and system risk management systems, customer protection handling, etc.

Main New Items Added

II. Basic Policy for the Conduct of Inspections

- **Strengthen analysis abilities & information delivery abilities** (newly established item)
- **Enhance seamless on-site and off-site monitoring**
 - ✓ Enhance seamless on-site and off-site monitoring of system risks
- **Response to Great East Japan Earthquake** (newly established item)
 - ✓ Detailed handling of debtors, etc. by financial institutions (including handling of overlapping debt problem)
 - ✓ Considerations for financial institutions located in disaster areas

III. Basic Framework

- **Inspections of financial institutions, etc.**
 - ✓ Strengthen functions of Examiner in Charge (EiC: multiyear Chief Inspector system)
 - ✓ Exchange opinions with HQs of foreign banks, etc.
 - ✓ Focus on financial institutions which also engage in trust business and new coming banks, etc.

IV. Priority Inspection Items

- **Development of governance systems**
 - ✓ Governance of subsidiaries, etc. by financial holding companies
 - ✓ Development of business continuity management considering earthquakes, etc.
- **Further promotion to facilitate financing**
 - ✓ Establishment of financial practices which don't require third party individual co-guarantors
- **Development of legal compliance systems** (newly established item)
 - ✓ Ensure appropriateness, etc. of new business (including wholesale business)
- **Protection of Customers and Improvement of Users' Convenience**
 - ✓ System of follow-up after sale of risky products
 - ✓ Measures to prevent adverse effects during insurance solicitation by banks, etc.
- **Development of risk management systems**
 - ✓ Risk management of housing loans, considering their special characteristics
 - ✓ Liquidity risk management on a global basis
 - ✓ IT system risk, including of stably operating IT systems

Main Continuing Initiative Items

II. Basic Policy for the Conduct of Initiatives

- Promoting the Implementation of the Five Principles Prescribed in the Preamble of the Inspection Manual
 - Evolution of better regulation

III. Basic Framework

- Inspections of financial conglomerates of large financial groups
- Inspections of entrusted companies and agents of financial institutions

IV. Priority Inspection Items

- Development of governance system to accurately manage various risks
- Further promotion to facilitate financing
 - (Wield consulting function to support creation and execution of effective business improvement plans)
- Thorough management of information on customers, etc.
- Response to the financial ADR system
- Group-wide risk management of major financial groups
- Enterprise Risk Management of insurance companies

Reference: Composition of Basic Policy for Financial Inspections

I. Introduction

- Has it developed procedures and arrangements to play a role in smooth and appropriate financing to borrowers, etc.?
- Has it built a sufficient financial base and a robust and comprehensive risk management system?

II. Basic Policy for the Conduct of Inspection

1. Promoting the Implementation of the Five Principles Prescribed in the Preamble of the Inspection Manual
 - Inspection Focusing on Important Risks
 - In-Depth Analysis and Clarification of Causes of Problems Necessary for Fundamental Improvement
 - Identification of Problems, Evaluation of Appropriate Improvement Efforts, and Examination of Static and Dynamic Aspects
 - Explanation of the Basis for Ratings and Pointing out Problems, and Clarification of Items to Be Considered for Improvement
 - Accurate Understanding of Examination Findings (Sense of Satisfaction)
2. Initiatives for the progress of better regulation
3. Strengthen analysis abilities and information delivery abilities
4. Enhance seamless on-site and off-site monitoring
 - Stronger monitoring of IT system risks
 - Promotion of initiatives in Financial Bureaus
5. Response to Great East Japan Earthquake

III. Basic Framework for Various Inspections

- Major banks
 - Strengthen functions of Examiner in Charge (EiC: multiyear Chief Inspector system)
- Large financial groups
 - Handling of business development on a global basis
- Regional financial institutions
 - Conduct more focused inspections
- Foreign banks, etc.
 - Exchange opinions with headquarters and home country authorities
- Financial institutions which also engage in trust business, and new coming banks
 - Development of risk management system based on business characteristics
- Insurance companies
 - Inspections based on the revised Inspection Manual for Insurance Companies
- Financial companies, etc.
 - Inspections in response to the full enforcement of the revised Money Lending Business Act
- Entrusted companies and agents
 - Actively conduct inspections of outsourcing contractors and agents

IV. Priority Inspection Items

1. Development of Governance System

- Under leadership of management, group-wide governance system
- Situation of wielding governance functions of financial holding companies
- Construction of business continuity management considering examples of crises such as earthquakes

2. Further promotion to Facilitate Financing

- Business improvement by wielding appropriate consulting function of financial institution
- Active support when changing conditions of loans for SMEs and housing loans

3. Development of Legal Compliance System

- Exclusion of antisocial forces from financial transactions
- Ensure appropriateness etc. of new business, including wholesale business

4. Protection of Customers and Improvement of Users' Convenience

- Protection of customers
 - Thorough management of information on customers, etc.
 - Active responses to consultations and complaints (including handling of financial ADR system)
 - Appropriate explanations to customers
- Improvement of user's convenience

5. Development of Risk Management System

- Comprehensive risk management
 - Comprehensive risk management systems commensurate with the size, characteristics and risk profile
- Credit risk management
 - Properly conduct screening and manage large-lot credit exposure, credit exposure related to syndicated loans and loans to overseas clients, etc.
 - Risk management system for housing loans
- Market risk management
 - Effective management systems such as loss limits
- Liquidity risk management
 - Liquidity management on a global basis
- Information technology system risk management
 - IT system management, including stably operating systems
 - Handling of joint systems, outsourcing, progress of cloud services
- Group-wide risk management of large financial groups
- Risk management in insurance companies